FROM		
NAME & TITLE	Thomas P. Taneyhill, Executive Director	
AGENCY NAME & ADDRESS	Fire and Police Employees' Retirement System 7 E. Redwood Street, 19th Floor	
SUBJECT	City Council Bill 08-0220	

CITY of BALTIMORE

MEMO

CITY OF BALTIMORE 1797

TO

DATE: March 18, 2009

The Honorable President and Members
of the Baltimore City Council
Attn: Karen Randle, Executive Secretary
Room 409, City Hall
100 N. Holliday Street
Baltimore, Maryland 21202

Re: City Council Bill 08-0220 – Fire & Police Employees' Retirement System – Benefits – Post-Retirement Increases

Dear Madam President and City Council Members:

The purpose of City Council Bill 08-0220 is to amend provisions of the Fire and Police Employees' Retirement System law pertaining to the method for determining annual post-retirement increases by discontinuing the current method for determining post-retirement benefit increases and by establishing a new method which would guarantee a fixed annual increase be paid to System retirees and beneficiaries.

At their meeting on Tuesday, March 17, 2009 the Board of Trustees of the Fire and Police Employees' Retirement System reviewed the proposed provisions of City Council Bill 08-0220 in conjunction with the opinion of the Law Department regarding whether the variable benefit provisions could be amended. The Board voted to advise the City Council that Bill 08-0220 is administratively workable provided the annual increase limitation is changed from the CPI-U to the CPI-Washington/Baltimore/Virginia regional index.

LEGISLATIVE HISTORY

- Prior to June 1983, increases to retirees were made only by special City Council legislation.
- The current post-retirement benefit increase provision was established June 1983 by City ordinance.
- The concept was to take the "cream off the top" and use it for retirement increases.

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- The increases were to not result in additional F&P contributions by the City.
- The idea of a cost of living adjustment (COLA), such as a CPI-based increase was rejected.
- For the first time "eligible" retirees and beneficiaries were provided automatic increases if F&P investment performance provided "excess earnings."
- F&P post-retirement benefit increases became known as "Variable Benefits."

HOW THE CURRENT "VARIABLE BENEFIT" PROVISION WORKS

- Investment performance is determined each June 30 year end.
- If investment performance exceeds 7.5%, retirees and beneficiaries receive a percentage increase in retirement benefits.
- In general, members retired for 2 or more years as of the June 30 determination date are eligible for any increase.
- The increase is not tied to the Consumer Price Index (CPI).
- The increase percentage varies from year to year.
- New increases are compounded on the basic benefit and prior increases.
- There is no minimum rate automatically paid.
- There is no maximum increase rate.
- Previously awarded variable benefit increases are not guaranteed by the City.
- The plan provisions require that the "variable benefit" assets be invested separately from the regular plan assets.
- The "variable benefit assets" can only be used to pay post-retirement increases.
- As of February 28, 2009, the "variable benefit" assets are valued at $469.5 million.
- Variable benefit assets comprise 29.5% of total plan assets of $1.6 billion.

THE REASONS FOR THE NEED TO CHANGE THE F&P PLAN PROVISION

The F&P actuary has advised the Board of Trustees of the following problems with the current post-retirement benefit increase provisions:

- Expected future investment performance less amounts allocated to pay post-retirement benefit increases will not leave enough money in the F&P to pay for the basic retirement benefits; i.e. the benefits paid at retirement.
- Retirees participate and receive increases when investment performance is good.
- Poor investment performance does not impact variable benefit increases.
- When investment performance is poor, the City's contribution to the F&P increases.
- Too many assets needed to be set aside to pay the increases.
- When investment performance is below 7.5%, retirees do not receive an increase.

SOLUTIONS TO THE CURRENT VARIABLE BENEFIT ISSUES

The F&P's actuary made the following recommendations to the Board of Trustees:

- Lower the post-retirement asset earnings assumption from 6.8% to 5.0% which will result in a $61.5 million per year increase in the City's contribution to the F&P, in addition to the $81.9 million contribution requirement due July 1, 2009, or
- Change the post-retirement increase mechanism so that more assets stay in the plan to pay for the basic benefits.

HOW THE PROPOSED VARIABLE BENEFIT INCREASE PROVISION WILL WORK (City Council Bill 08-0220)

- A 1.5% increase will be provided each January, regardless of investment performance.
- An additional benefit increase will be paid each January on top of the 1.5% fixed rate if investment performance exceeds 8.0% on a cumulative basis as determined as of each June 30.
- All prior variable benefit increases and all new increases will be guaranteed by the City.
- Good investment performance as well as poor investment performance will be factored. (This means the retirees will participate in poor investment years.)
- The fixed and the "additional" increases will be limited by the change in the consumer price index (CPI-U) from June of the prior year to June of the current year.
- There will be no required separate investing of "variable benefit" assets as there is currently.
- All variable benefit assets, approximately $469.5 million, will be re-allocated to the Board's general strategic asset allocation plan.
- Over time the re-allocation of the variable benefit assets should provide a greater opportunity for investment earnings.
- The same eligibility rules will apply; members must be retired for 2 or more years as of the June 30 determination date.
- The increases will be compounded on the base retirement benefit and all prior increases.
- The earnings available for the proposed variable portion of the increase will be phased-in over 4 years.
- The phase-in structure is to avoid providing a large increase early in the new program followed by years of poor investment performance.

COST OF CITY COUNCIL BILL 08-0220 PROPOSED PROVISIONS

As per the November 17, 2008 cost estimate of City Council Bill 08-0220 prepared by Douglas L. Rowe of Mercer, Actuarial Consultant to the Board of Trustees of the Fire and Police Employees' Retirement System, the proposed provisions have an initial cost of $7.7 million per year.

It must also be noted that while there is a cost to the City Council Bill, the Actuary has stated to the F&P Board of Trustees that to do nothing will cost the City more than the estimated cost of $61.5 million per year if the post-retirement asset earnings assumption rate was lowered from 6.8% to 5%.

RECOMMENDED AMENDMENT

The Board of Trustees of the Fire and police Employees' Retirement System recommends that the annual increase limitation contained in the proposed Bill be changed from the CPI-U which is the all urban consumer price index maintained by the Department of Labor to the Washington/Baltimore/Virginia Index which takes into consideration the higher cost of living in the DC/Maryland area.

ATTACHMENTS

- Recommended Amendment to City Council Bill 08-0220 as requested by the F&P Board of Trustees.
- November 17, 2008 letter from Douglas L. Rowe, Actuary.
- Schedule of Investment Income and Variable Benefit Increase Comparison to Social Security Increase and CPI-U Increase.
- Average Variable Benefit Increases for Various Periods Determined as of June 30, 2008.
- Average Variable Benefit Increases for Various Periods if investment earnings are below 7.5% as of June 30, 2009.
- Average Variable Benefit Increases for Various Periods if investment earnings are below 7.5% through June 30, 2011.

I will attend the City Council hearing to provide testimony on this bill. Please let me know if I can provide any additional information.

cc: Angela Gibson, Mayor's Legislative Liaison to the City Council

FIRE & POLICE EMPLOYEES' RETIREMENT SYSTEM
BOARD OF TRUSTEES

RECOMMENDED CHANGES TO CITY COUNCIL BILL 08-0220

Fire & Police Employees' Retirement System – Benefits
Post-Retirement Increases

On Page 6, lines 33-34, after "for the", delete "U.S. city average' and insert "Washington-Baltimore, DC-MD-VA-WV CMSA".

On page 6, line 34, after "items", delete "(1982 – 84= 100)" and insert "(November 1996= 100)".

On page 6, line 35, after "preceding" delete "June" and insert "May, or the closest comparable regional and periodic statistical data issued by the U.S. Bureau of Labor Statistics applicable to the annual variable increase being calculated."

Douglas L. Rowe
Principal

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MERCER

MMC MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

November 17, 2008

Mr. Thomas P. Taneyhill, CPA
Executive Director
Fire and Police Employees' Retirement System
7 E. Redwood Street
4th Floor
Baltimore, MD 21202

Subject: Cost Estimate of City Council Bill 08-0220

Dear Tom:

As requested, we have prepared estimated cost increases to the City due to the proposed legislation. Below is a summary of the proposed changes to the current plan structure:

- Modifies the post-retirement interest rate assumption from 6.80% to 7.75%
- Suspends future post-retirement benefit increases under the current variable benefits structure, effective June 30, 2008
- Transfers assets from the Paid-up Benefit Fund and the Contingency Reserve Fund into the general asset account (Annuity Reserve Fund, Pension Accumulation Fund, Pension Reserve Fund, Annuity Savings Reserve), effective June 30, 2009
- Transfers post-retirement benefit liabilities from the Paid-up Benefit Fund to the Pension Reserve, effective June 30, 2009
- Provides automatic annual benefit increases to retirees of 1.50% for retirees who have been retired for 2 or more years, effective January 1, 2010,
- Establishes the variable increase account to provide for benefit increases if cumulative investment returns in the ARF/PRF are over 8%, effective June 30, 2009
- Limits the combined automatic 1.50% increase and any increases from the variable increase account to the CPI-U
- Exempts retirees from Basic DROP from the 2-year wait requirement for benefit increases

While the proposed legislation would result in an immediate increase to the plan contributions, it is anticipated that over time this would result in cost savings. This is due to several factors:

- The variable increase account would be invested in the same proportion of stocks and bonds as the General Asset Account and would not consist of segregated assets for investment purposes. The Paid-up Benefits Fund and Contingency Reserve Fund, which the variable increase account would be replacing, are invested primarily in fixed income securities and are anticipated to yield lower returns over the long-term. If higher investment returns are realized, this could lower the cost of benefit changes.

- The amount of funds to be used for variable benefit increases would also be limited to 20% of returns over 8% as opposed to 100% of returns between 7.5% and 10% and 50% of returns over 10%. There is also a 4-year phase-in period for the 20% limit. The limit is 5% as of June 30, 2009 and increases by 5% per year until it reaches the ultimate limit of 20% as of June 30, 2012.

- Benefit increases due to the proposed variable increase account would also be smoothed such that the availability for benefit increases is based on accumulated investment returns beginning June 30, 2009 through each subsequent year. Under the current variable benefits structure, benefit increases are based on the investment return for each year.

- Annual benefit increases would also be limited by the CPI-U. The current variable structure does not have a limit on benefit increases.

While we anticipate that the proposed bill would reduce City contributions over time, the initial impact is a contribution increase. The table below shows the estimated increase in Actuarial Accrued Liability and the City's annual contribution for the first year, rounded to the nearest thousand:

1. Estimated increase to actuarial accrued liability at July 1, 2008:	*$ 48,000,000*
2. 20-year amortization at end of year:	*4,900,000*
3. Estimated increase to normal cost at end of year:	*2,800,000*
4. Estimated additional contribution for FY 2010 *(2) + (3):*	***$ 7,700,000***

The ongoing cost of the proposed structure is based on the increase to the normal cost ($2.8M), which is anticipated to grow as a percentage of active payroll assuming that other population demographics are consistent from year to year. Under the F&P's current funding method, the amortization component of the additional contribution would decrease over time.

The guaranteed annual increase that could be provided with no current increase in City contributions is 1.27%.

The actual cost of the proposed bill would be determined based on demographic and financial data as of June 30, 2009.

Our calculations are based on the following:

- For purposes of this calculation we have only reviewed the short-term implications of the proposed bill. A longer-term picture would require the analysis of multiple investment scenarios, which we can prepare at the City's request.
- We assumed that the CPI limit would have no impact on benefit increases
- Benefit liabilities were calculated as of June 30, 2008.
- Assets as of June 30, 2008, but reflecting investment losses in the Paid-up Benefits Fund and Contingency Reserve Fund between June 30, 2008 and September 30, 2008.
- Based on the information provided, the proposed plan change would probably first be reflected in the June 30, 2009 actuarial valuation. This, in turn, would impact the City's contribution for the fiscal year ending June 30, 2011.
- Except as noted earlier, all actuarial assumptions, methods, and plan provisions utilized in this analysis are the same as those used for the June 30, 2008 valuation report.

MERCER

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Collectively, the undersigned credentialed actuaries meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this analysis. Please give us a call if you have any questions.

Douglas L. Rowe	November 17, 2008
Douglas L. Rowe, FSA, MAAA, EA	**Date**
James Baughman	November 17, 2008
James Baughman, ASA, EA	**Date**

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Fire and Police Employees' Retirement System
Variable Benefit Increase Comparison to Social Security Increase and CPI-U Increase

Fiscal Year	Investment Income	Variable Benefit Increase	Social Security Increase	CPI-U Increase
1983	41.6%	1% to 20% * plus 9.66%	3.5%	2.58%
1984	0.0	0.00	3.5	4.22
1985	26.8	10.39	3.1	3.76
1986	24.8	8.67	1.3	1.77
1987	12.9	3.38	4.2	3.65
1988	(0.1)	0.00	4.0	3.69
1989	16.1	4.81	4.7	5.17
1990	10.9	2.21	5.4	4.67
1991	7.4	0.00	3.7	4.70
1992	13.0	3.44	3.0	3.09
1993	12.6	3.43	2.6	3.00
1994	2.2	0.00	2.8	2.49
1995	16.1	4.86	2.6	3.04
1996	17.6	5.71	2.9	2.75
1997	22.0	7.33	2.1	2.30
1998	21.0	6.33	1.3	1.68
1999	11.0	1.75	2.5	1.96
2000	7.5	0.00	3.5	3.73
2001	(6.7)	0.00	2.6	3.25
2002	(8.6)	0.00	1.4	1.07
2003	(0.1)	0.00	2.1	2.11
2004	16.3	4.05	2.7	3.27
2005	11.6	2.20	4.1	2.53
2006	12.0	2.60	3.3	4.32
2007	19.4	5.34	2.3	2.69
2008	(7.5)	0.00	5.8	5.02

Investment income is the return percentage for the Variable Benefit increase calculation presented ir the actuarial valuation report.

The variable benefit increase percentage is paid beginning in the January following the June 30 fisca

The Social Security increase percentage is from the Social Security Cost-of-Living Adjustment Schec

The CPI-U percentage increase is calculated from June to June and is from the U.S. Department of Labor, Consumer Price Index, All Urban Consumers Schedule.

FIRE AND POLICE EMPLOYEES' RETIREMENT SYSTEM

POST RETIREMENT BENEFIT INCREASES
"VARIABLE BENEFITS INCREASES"

AVERAGE INCREASES DETERMINED AS OF JUNE 30, 2008

Number of Average Years	Average Variable Benefit Increase	Average Social Security Increase	Average CPI-U Increase
Since inception	3.35% - 4.08%	3.0%	3.17%
25	3.06%	3.1%	3.20%
20	2.70%	3.1%	3.14%
15	2.68%	2.8%	2.81%
10	1.59%	3.0%	3.00%
7	2.03%	3.1%	3.00%
5	2.84%	3.6%	3.57%
3	2.65%	3.8%	4.01%
1	0.00%	5.8%	5.02%

FIRE AND POLICE EMPLOYEES' RETIREMENT SYSTEM

POST RETIREMENT BENEFIT INCREASES
"VARIABLE BENEFITS INCREASES"

AVERAGE INCREASES AS OF JUNE 30, 2009 IF INVESTMENT EARNINGS ARE BELOW 7.5% UTILIZING CURRENT VARIABLE BENEFIT PROVISIONS

Number of Average Years	Average Variable Benefit Increase
Since inception	3.35% - 4.08%
25	3.06%
20	2.46%
15	2.68%
10	1.42%
7	2.03%
5	2.03%
3	1.78%
1	0.00%